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AMERICA'S INTERNATIONAL POSITION: DEBTOR OR CREDITOR?

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Assertions have been made that in 1985, for the first time in 65 years, America's net foreign assets position shifted from that of a net creditor to a net debtor. Moreover, when all the numbers were added up and compared, many observers claimed that the United States emerged, not only as a debtor country, but as the world's largest debtor. Brazil, whose moratorium on debt service payments last February continues to cause consternation in financial circles, has a total foreign debt which is only a little over two-fifths of the U.S. debt.

This development has led to a multitude of articles detailing the "foreign flags flying over the American economy," and presaging dire consequences when the "day of reckoning" arrives. The implication is twofold: first, that foreign direct investment (FDI) in the United States is harmful; and second, that at some future date our descendants will be faced with the burden of repaying our extravagances, and will experience the same hardship that the Mexicans, Brazilians and citizens of other indebted developing countries are suffering today.

This paper demonstrates that concerns over the net foreign assets position of the United States is exaggerated, and may, in fact, be entirely misplaced. Indeed, there is enough evidence to suggest that the U.S. may not be a net international debtor at all. But even accepting the current figures, it can be shown that the circumstances surrounding the United States are far removed from those of the problem debtors.

Debtor or Creditor?

It has been widely debated whether the following statements are true or false: The United States now far outdistances Brazil as the world's largest debtor nation, and the

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United States now rivals Japan as the world's largest creditor nation. Depending on how one looks at the data, the answer to both questions is true–a logical impossibility. An examination of the data proves why that is so.

According to official data from the Department of Commerce, at the end of 1986, the U.S. had a net international debt of $263 billion, compared to Brazil's debt of $110 billion. But comparing the U.S. debt to that of Brazil, or any other problem debtor, is like comparing apples to oranges. For example, the debt of the LDCs, as it is now computed, only includes financial borrowings from foreign banks, governments and multilateral agencies, net of official foreign reserves. In contrast, America's debt, as it is computed and reported, also includes net foreign direct investment and private assets.

In addition, direct investment by American companies abroad and by foreigners in America are recorded at book value. Yet, the average age of the U.S. stock of direct investment abroad is much older than foreigners' investment in the U.S. This means that if direct investments were revalued at current market prices, the value of U.S. investments abroad would rise by much more than the value of foreigners' investments in the U.S. As a result, the net foreign position of the U.S. would improve drastically. Furthermore, U.S. gold reserves are still valued at $42.22 an ounce. If America's 262 million ounces of gold were valued at today's market value, U.S. assets would be boosted by about $100 billion. Jason Benderly of Goldman Sachs, estimates that if America's assets and liabilities were valued correctly, at the end of 1986 the U.S. had net foreign assets of approximately $200 billion. This figure is roughly equivalent to Japan's, supposedly the world's largest creditor nation. 1

Comparing Apples and Oranges

In addition to the doubtful nature of the data for the U.S. international debt, there are even more important reasons why the parallel with the current plight of the indebted LDCs is inappropriate. In 1986, the net international debt position of the United States amounted to 6.3 percent of GNP. That does not even begin to compare with the problem debtors whose external debt, according to the International Monetary Fund, averaged 54.8 percent of their GDP.

A more important distinction, however, is the use to which the borrowed funds are put. The problem debtors are in their current situation because much of the funds borrowed from abroad were used to finance current consumption and at times, capital flight. Despite claims to the contrary by some analysts, including the Joint Economic Committee staff, that is not the case in the U.S.

A recent Joint Economic Committee study claims that "the U.S. net debt...largely reflects a higher rate of consumption in the United States...rather than increased investment." This assertion stems from the fact that only 28 percent of the foreign assets in the U.S. are in direct and equity investment. The argument continues to claim that the U.S. government consumes too much, thus absorbing private savings. Hence, foreigners must invest more in the U.S. than Americans invest abroad in order to finance this "excess government consumption." 2

But contrary to the widespread claims of a U.S. consumer binge, private consumption has increased only at average rates during the current expansion (20.5

percent compared to 21.1 percent during the 1975-79 recovery). The same is true of investment in producers' durable equipment (43.6 percent increase since the recovery began, compared to 41.9 percent in the 1975-79 period). Imports are the only sector experiencing a faster than average growth rate during the current cycle. But the increase has not been dramatically faster–a 54.8 percent increase since the end of the recession, compared to 48.4 percent in the 1975-79 recovery.

The key to the argument is not private but public consumption. Government spending has, in fact, increased very rapidly as evidenced by the budget deficit. However, this argument assumes that the U.S. government does not invest. But as economist Alan Reynolds has shown, the U.S. government invests in infrastructure such as highways, schools, dams, subways, airports, etc. The government also uses capital equipment such as fire engines, police cars and computers. It is therefore, wrong to assume that all government spending is consumption. This confusion can be attributed to the fact that the U.S. is the only industrial nation that does not separate public investment from public consumption in its official data.

Given that the U.S. government invests as well as it consumes, it cannot be said that the debt incurred has been for "nonproductive purposes." To the contrary, the yield from most government investment is "a healthier, more educated labor force, greater security of property rights, a better transportation network..." 3 Such investments raise the economy's output and income, and this in turn, allows for the servicing of the debt.

What do the Numbers Really Show?

Nevertheless, we can only debate this issue on the basis of the officially available data. Keeping these two caveats in mind: That the figures may be significantly overstating the actual situation, and that there is no basis of comparison with the indebted LDCs, an examination of the factors that contributed to the ballooning of the measured foreign debt is necessary.

The bulk of foreign direct investment in the United States is in the hands of West Europeans. Traditionally, European investment in the U.S. has accounted for two-thirds of total FDI and has been concentrated in manufacturing industries. That relationship has changed only slightly. For example, out of a total of $24.7 billion in new FDI in 1986, Western Europeans held $17.2 billion, or 69.6 percent. Japanese investment, on the other hand, increased by $5.1 billion in 1986, accounting for 20.6 percent of the total increase. Contrary to the popular notion, Japanese investment is not confined to auto manufacturing but is concentrated in the financial and wholesale (service) sectors. Finally, the Latin American and Middle Eastern countries both reduced their investments in the U.S. last year.

Manufacturing investments continue to dominate the attention of foreign investors, followed by the petroleum and insurance sectors. Foreign investments have also grown in commercial real estate. Foreign investors now own 46 percent of the commercial real estate of downtown Los Angeles, 39 percent of Houston, 32 percent of Minneapolis and 21 percent of Manhattan. The British (who burned Washington in 1814), have now built or bought an estimated $1 billion in the District of Columbia. And Japanese investors recently bought the Exxon headquarters building in Manhattan for $610 million, the highest price ever paid for a skyscraper.

Esteemed U.S. corporate nameplates are also changing hands. Doubleday books has gone to the West Germans; Brooks Brothers clothiers to the Canadians; Smith & Wesson handguns to the British; General Electric television sets have been bought by the French; Carnation Foods by the Swiss; and General tires by the West Germans.

This "foreign investment wave" has indeed become controversial. But has there really been a dramatic change in FDI? The answer, as Table 1 makes clear, is no. Foreign direct investment in the U.S. has changed relatively little since 1980. With the exception of 1982 and 1983 when the recession and its aftermath reduced the attractiveness of investing in the U.S., the annual increase in foreign investment has hovered around $25 billion. Foreign investment in the U.S. rebounded strongly in 1984 but the post-recession average remains below the 1980-1981 average.

TABLE 1

CHANGE IN FOREIGN DIRECT INVESTMENT
1980-1986
[Increase (decrease) from previous year in billions of dollars]

	1980	1981	1982	1983	1984	1985	1986
U.S. Investment Abroad	27.6	12.9	-20.5	-0.6	4.3	18.3	30.1
Foreign Investment in U.S.	28.5	25.7	16.0	12.4	27.5	20.0	24.7

Source: U.S. Department of Commerce.

It is U.S. direct investment overseas (not FDI in the U.S.), that explains the shift in the net investment position of the United States. American investment abroad declined sharply in 1982 and 1983 and, although it has recovered since then, the average change in U.S. investment abroad during the past three years remains significantly below the 1980-1981 average. The reason for this is the relative attractiveness of investment in the United States. In particular, the decline in U.S. marginal tax rates placed the U.S. at a comparative advantage over other industrial countries.

Once the final phase of tax reform goes into effect, the U.S. will have the lowest top marginal tax rate on personal income of any OECD country. Despite the fact that other industrial nations (including Japan and Germany), have proposed reductions in their top marginal tax rates, the U.S. tax rate will remain the lowest. Moreover, no other OECD nation can match the magnitude of the U.S. decline in the top tax rate.

The significance of the lower tax rate is that it creates an economic environment conducive to growth and investment. Numerous studies show that the countries with higher tax rates had very weak investment growth. For instance, the U.S. with a marginal tax rate of 42.6 percent in 1983 experienced a 5 percent growth in capital formation during 1980-85. At the other extreme, Belgium, with a marginal tax rate in 1983 of 61.7 percent experienced a 4 percent decrease in capital formation during that same period. 4

It is important to remember that foreign investment creates new jobs. Foreign investment is directly responsible for nearly 3 million jobs in the U.S., roughly equal to the total civilian work force of Massachusetts or Virginia. Increased productivity also results from increased investment in more and better machinery and equipment. Over $63,000 worth of buildings and equipment are required to employ the average worker in the private sector. Moreover, foreign funds are an important source of venture capital. Of the $2.3 billion in venture capital funds raised last year, nearly 25 percent came from overseas. These investors are not so much interested in the promise of financial gain as they are in the wealth of new technology they hope to develop.

There is nothing intrinsically wrong with importing capital, particularly when it is used to finance productive investment. The data show that the largest increases in foreign assets in the U.S. take the form of direct investment and equity investment. The U.S. has enjoyed far more rapid economic growth than would have been possible without foreign investment. In 1986, for example, U.S. individuals and corporations saved $680 billion and the government borrowed $143 billion to finance the budget deficit. If there had been no foreign capital inflow, private investment in the U.S. could not have exceeded $537 billion.

Other Contributing Factors

Another contributing factor to the decline in U.S. investment abroad was the LDC debt crisis, which not only affected U.S. direct investment in those countries but also bank claims. As U.S. banks virtually stopped lending to the problem debtors, U.S. bank claims fell dramatically. In 1982, U.S. lending to problem debtors collapsed. After increasing by $111.1 billion in 1982, claims reported by U.S. banks increased by only $1.8 billion in 1985. While bank claims recovered in 1986, the increase ($59 billion) remains well below the 1981 and 1982 levels.

TABLE 2

CHANGE IN U.S. CLAIMS REPORTED BY U.S. BANKS
(increase from previous year in billions of dollars)

1980	1981	1982	1983	1984	1985	1986
46.9	89.6	111.1	29.2	11.1	1.8	59.0

Source: U.S. Department of Commerce.

The surge in the U.S. stock market also played a role in the shift in the U.S. net foreign assets position. Foreign holdings of U.S. stocks increased dramatically in 1985 and 1986, reflecting rising corporate profits, low inflation and falling interest rates (see Table 3).

TABLE 3

CHANGE IN EQUITY INVESTMENT
(increase from previous year in billions of dollars)

	1980	1981	1982	1983	1984	1985	1986
U.S. Purchase of Foreign Securities	5.9	0.7	12.1	8.3	5.3	23.7	18.2
Foreign Purchases of U.S. Securities	15.5	1.0	17.9	20.7	13.6	79.3	102.9

Source: U.S. Department of Commerce.

A recent study by the Joint Economic Committee concludes that extremely tight monetary policy drove up interest rates in the U.S., thereby creating a very strong foreign demand for dollar-denominated assets. The resulting surge in the value of the dollar, combined with strong growth in domestic demand stimulated by large federal budget deficits, led to a sharp loss of U.S. competitiveness and drove the trade and current account deficits to unprecedented levels. The JEC concludes that the problems created by fiscal and monetary policies were aggravated by the inability of the U.S. to persuade the major industrial nations to grow more rapidly, the failure to develop a strategy for economic growth in the debtor nations, and significant neglect of problems of productivity and competitiveness in American industry. 5

The data, however, paints a different picture. Foreign holdings of U.S. Treasury securities surged in 1984 and 1985, but this represented a relatively small proportion of total foreign assets in the U.S. and the trend appears to have reversed itself in 1986. After rising by 72 percent in 1984 and 44 percent in 1985, foreign holdings of U.S. Treasury securities rose by only 15 percent last year. As a result, they are now 7.2 percent of total foreign assets in the U.S., down from almost 8 percent in 1985.

TABLE 4

FOREIGN HOLDINGS OF U.S. TREASURY SECURITIES
(increase from previous year)

	1980	1981	1982	1983	1984	1985	1986
$ Billions	1.9	2.4	7.3	8.1	24.3	25.4	12.4
Percent change	13.4	14.8	39.2	31.4	71.9	43.7	14.7
As percent of total	3.2	3.2	3.7	4.3	6.5	7.9	7.2

Source: *Survey of Current Business,* June 1987.

A major reason for the continuing demand for dollar-denominated assets is that the U.S. offers the best return on foreigners' investments. The fact that a large number of foreigners are investing in the U.S., rather than in their own countries, is a tribute to the strength of our economy as well as a warning about the weakness of a number of foreign economies. In general, the U.S. continues to be the only engine of growth in the world.

Conclusion

The concern over the likely consequences of the large international debt of the United States is overstated. And, inasmuch as the shifts in FDI, U.S. bank claims, foreign holdings of securities and other components of U.S. financial transactions, are the result of positive forces in the U.S. (higher real after-tax returns on investment, lower investment risk) and negative forces abroad (lackluster growth of most major foreign economies, high risks of default, nationalization or war in the LDCs), the appropriate U.S. response should be to encourage the same salutary environment elsewhere, not to infect the U.S. economy with the cancers that are sapping the strength of foreign economies.

Unfortunately, there is legislation being considered in Congress which will do just that. The House trade bill includes a provision known as the Bryant Amendment, which would require foreign investors to register and report information concerning their U.S. operations for public disclosure. This applies to both privately and publicly held companies. This proposal is not only discriminatory, it is redundant. This nation already has a number of statutes on the books which provide for the collection of information about foreign investors as well as regulate various industries on an ongoing basis. The enactment of the Bryant Amendment will only serve to discourage further FDI. American legislators would do well to remember that after several decades of experimenting with different development strategies, it is now abundantly clear that the nations that prospered were those that welcomed foreign capital and technology. The nations that failed are those that attempted to prosper behind high tariff walls, closing themselves off to foreigners in a vain effort at becoming self-sufficient in an increasingly interdependent world economy.

The challenge facing today's policymakers is maintaining the U.S. economy on a steady growth path. As long as the notion that the U.S. foreign debt rivals Brazil's continues to be believed, the risk of enacting Brazil's solutions could occur. Recall that Brazil did turn its trade deficit into a surplus in 1985 in order to pay its external debt. But the cost was a painful recession. A recession will slash domestic demand for imports and in the process, impoverish our trading partners and reduce their interest or ability in investing in the U.S. That's an irresponsible solution to a problem that may not even exist.

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Footnotes

[1] "Well, would you debit it?" *The Economist* (London: The Economist Newspapers, Ltd., August 1, 1987) p. 73.

[2] Joint Economic Committee, "The Economy at Midyear: A Legacy of Debt," August 1987.

[3] Alan Reynolds, "Public Investment, Not a Binge," *The Wall Street Journal,* July 27, 1987.

[4] Alan Reynolds, "The Investment Opportunity Theory of Capital and Trade Flows," (Morristown, New Jersey: Polyconomics, Inc., May 27, 1987) p. 6.

[5] Joint Economic Committee, op. cit.